



NEWS RELEASE

CALIFORNIA STATE TREASURER PHIL ANGELIDES

MEDIA ADVISORY

October 7, 2004

CONTACT: Mitchel Benson

(916) 653-4052

**STATE TREASURER ANGELIDES BRIEFS MEDIA ON TIMELINE,
CHALLENGES FOR SCHEDULED, UPCOMING SALES OF PENSION
OBLIGATION BONDS AND TRIBAL ASSETS SECURITIZATION BONDS**

SACRAMENTO, CA – State Treasurer Phil Angelides today updated the news media on the planned sale of approximately \$935 million in Pension Obligation Bonds (POBs) and up to \$1.5 billion in Tribal Assets Securitization Bonds (tribal gaming bonds) that were included in the 2004-05 State budget. The Treasurer discussed his Office's planned timeline for the two sales, and the potential challenges the State will face in trying to bring the bonds to market.

A recorded replay of today's teleconference will be available through 11:59 pm PDT on Friday, October 8. Call-in number for the replay is (888) 568-0873. Attached please find charts the Treasurer referred to during his presentation.

#

OFFICE OF THE TREASURER

P. O. BOX 942809
SACRAMENTO, CA 94209-0001



**PENSION OBLIGATION BONDS AND
TRIBAL ASSETS SECURITIZATION BONDS
FACT SHEET**

The 2004-05 budget signed by Governor Arnold Schwarzenegger relies upon approximately \$7 billion in new borrowings, including two new bond sales. At the Governor's request, the budget assumes the sale of pension obligation bonds to cover \$929 million of the State's retirement contributions to the California Public Employees' Retirement System (CalPERS). In addition, the budget also assumes, as the Governor proposed, that the State will repay \$1.2 billion of a loan from the Transportation Congestion Relief Fund by issuing Tribal Assets Securitization Bonds (tribal gaming bonds). These bonds are to be secured by promised payments from casinos under recently enacted tribal gaming compacts. Both borrowings face significant legal hurdles, are more complicated than traditional state borrowings, and could prove to be expensive for California's taxpayers. In addition, the State Treasurer's Office estimates that the tribal gaming bonds will yield approximately \$350 million less than the budget anticipates.

Pension Obligation Bonds

The Governor's budget plan authorizes the sale of up to \$2 billion of pension obligation bonds in any two fiscal years after June 30, 2004. The 2004-05 fiscal year budget relies on \$929 million in bond proceeds to pay a portion of the State's retirement obligations to CalPERS. The pension bonds will have a term of 20 years, and will be repaid from the General Fund.

Legal uncertainties and complexity

Before the bonds can be sold, they will have to be validated in court, a process that tests the legality of the bond issue. It is uncertain whether the pension bonds will survive that court scrutiny. The Sacramento County Superior Court in September 2003 blocked the issuance of similar pension obligation bonds proposed by then-Gov. Gray Davis and approved in the 2003-04 budget. At the time, the court ruled that California's Constitution prohibits the State from incurring more than \$300,000 of long-term debt without a vote of the people. The pension bonds in the current budget, which have not received voter approval, are vulnerable to the same constitutional challenge.

Moreover, it is questionable whether the pension bonds meet the terms and spirit of Proposition 58, The California Balanced Budget Act, which the Governor and the Legislature placed before voters in the March 2004 election and which the voters approved. Proposition 58 prohibits deficit borrowing beyond the \$15 billion in Economic Recovery Bonds (ERBs) authorized by the companion measure, Proposition 57.

The message to voters in support of Propositions 57 and 58 was clear: Approve the \$15 billion of bonds in Proposition 57, and then close the door forever on deficit financing with Proposition 58. The Official Title and Summary of Proposition 58 told voters that the measure "prohibits any future deficit bonds." The ballot rebuttal to the argument against Proposition 58, which the Governor signed, unambiguously told voters that, "Proposition 58 prohibits borrowing for future deficits." Or, as he argued, "We should not be allowed to SPEND MORE MONEY THAN WE HAVE." (Emphasis in

original.) Proposition 58 prohibits the use of general obligation bonds or other multi-year borrowing “to fund a year-end state budget deficit.”

While Proposition 58 enumerates certain exceptions to the prohibition, the pension obligation bonds fail to qualify for any of them: The pension bonds are proposed for a term of 20 years, so they would not be considered a short-term borrowing, and they would not finance debt accumulated prior to June 30, 2004.

Costs

Even if the pension obligation bonds were to survive legal scrutiny, they will be expensive for California taxpayers. Unlike the ERBs issued earlier this year – which achieved high ratings in the market because they are supported by a dedicated quarter-cent of the state sales tax, and backed by the full faith and credit of the State – the pension bonds will be a General Fund obligation. They will likely carry the State’s underlying credit rating, which, despite recent upgrades, remains the lowest among all states. In addition, interest on the ERBs is tax-free to investors, while the pension bonds will be taxable – resulting in interest rates approximately 1.8 percent higher. In all, the Treasurer’s Office estimates that the proposed pension obligation bonds would cost taxpayers approximately \$1.6 billion in debt service (principal and interest) over 20 years. If the State were instead to fill this budget hole by issuing the same amount of the already authorized but as yet unsold Economic Recovery Bonds, California taxpayers could save approximately \$365 million over the life of the issue.

Tribal Assets Securitization Bonds

The Tribal Assets Securitization Bonds (tribal gaming bonds) will be issued by a special trust set up for this financing. It will use proceeds of the bonds to repay a portion of an outstanding loan to the General Fund from the Transportation Congestion Relief Fund. The bonds will be secured by a pledge of payments that the State expects to receive from five gaming tribes (Pala Band of Mission Indians, Pauma Band of Luiseño Mission Indians of the Pauma and Yuima Reservation, Rumsey Band of Wintun Indians, United Auburn Indian Community and the Viejas Band of Kumeyaay Indians) under compacts recently signed by the Governor and approved by the Legislature. Under the compacts, the tribes agreed to pay specified fixed fees over the next 18 years and, in addition, agreed to pay additional fees for new slot machines that are put into play later, as permitted under the agreements. The effect of this securitization is to take a new, ongoing revenue source and accelerate it to plug a one-time hole. By accelerating the payments, the State will receive \$968 million less than it would receive if the payments were received over the full 18 years.

Legal uncertainty

The tribal gaming bonds also face legal challenge. A lawsuit has been filed (*Glendon B. Craig, et al v. Arnold Schwarzenegger et al*, Alameda County Superior Court) challenging the urgency provision of AB 687, the legislation that approved the gaming compacts. The urgency provision allows a bill to become law immediately upon the Governor’s signature. The plaintiffs contend that AB 687 grants geographic monopolies to the tribes and, therefore, violates Article IV, Section 8(d) of the California Constitution. That provision bars the Legislature from granting any special privilege or franchise in an urgency statute. It is highly unlikely that the bonds could be sold unless this legal challenge is resolved in the State’s favor. In addition, if voters in November approve either Proposition 68 or Proposition 70, which are both related to tribal gaming, then the tribal gaming bonds could not be sold. That is because either of the ballot measures would erase the tribes’ obligations to make the annual payments necessary to support the bonds.

Complexity and Costs

The proposed financing structure, combined with the confidentiality pledges in the compacts that allow the gaming tribes to shield their financial information from the public, will likely yield less in proceeds than assumed in the budget and will add significantly to the costs of this borrowing.

The 2004-2005 budget assumes that the State can receive \$1.2 billion in proceeds from this bond issue, based on the State securitizing the tribes' fixed payment amounts called for in the compacts. But the Treasurer's Office estimates that those payments will permit the State to generate only approximately \$846 million in proceeds from the sale of the tribal gaming bonds.

The confidentiality provisions in the compacts do not permit the State to make the disclosures necessary for a normal public bond issue. In a normal public bond offering, the State would disclose to the public marketplace the financial condition of the entities whose operations provide the stream of income for bond repayment. The gaming compacts, however, do not require the gaming tribes to disclose their financial information to the public or financial marketplace.

Therefore, it appears at this time that these bonds will have to be sold in one of two ways, or a combination of both: a private placement with a select number of large, sophisticated investors, or a public offering that is fully guaranteed – for a fee – by banks and bond insurers that have reviewed the tribes' financial information. As a consequence, the State Treasurer's Office anticipates these bonds will be more expensive than a typical public offering. But, with so many uncertainties, it is difficult to predict precisely how much more costly.

In any event, the State Treasurer's Office will need access to the same financial information available to underwriters, banks, bond insurers and rating agencies, to sell these bonds. The Governor recently signed legislation that will allow the State Treasurer's Office and other State entities to examine the tribes' financial information without having to disclose that information to the public. The State Treasurer's Office does not yet have the assurances that it will be provided with the necessary financial information to enable it to sell the bonds. The tribes and State officials are currently negotiating over the release of that financial information to the State Treasurer's Office and other pertinent State officials.

MAJOR MILESTONES FOR BRINGING TO MARKET PENSION OBLIGATION BONDS AND TRIBAL ASSETS SECURITIZATION BONDS¹

Month/Year	Pension Obligation Bonds \$935 million ²	Tribal Assets Securitization Bonds Up to \$1.5 billion ³
October	<ul style="list-style-type: none"> Pension Obligation Bond Committee meets to approve legal validation action Legal validation action filed 	<ul style="list-style-type: none"> Discussions regarding financial disclosure Preliminary discussions with rating agencies Litigation (<i>Glendon B. Craig, et al v. Arnold Schwarzenegger et al</i>, Alameda County Superior Court)
November	<ul style="list-style-type: none"> Minimum period ends for public notice of legal validation action and for filing of responses to that action 	<ul style="list-style-type: none"> Proposition 68 & 70 election results Feasibility study of gaming revenues
December	<ul style="list-style-type: none"> Court hearing date Court judgment obtained and 30-day appeal period begins 	<ul style="list-style-type: none"> Secretary of State certifies election results
January 2005	<ul style="list-style-type: none"> Appeal period ends 	<ul style="list-style-type: none"> Document preparation Meetings with rating agencies, investors and credit enhancers
February 2005	<ul style="list-style-type: none"> Pension Obligation Bond Committee meets to authorize sale of bonds Meetings with rating agencies and investors Pricing 	
March 2005	<ul style="list-style-type: none"> Closing 	

¹ The estimated timeline is subject to a number of factors including, but not limited to, potential legal challenges, receipt of credit ratings, and market conditions.

² This timeline assumes Sacramento County Superior Court approval of the Pension Obligation Bonds. If the court rules against the POBs, as it did in September 2003, then it will be impossible to predict a sale date.

³ At this point, the litigation related to the Tribal Assets Securitization Bonds makes it impossible to predict a sale date for these bonds.

**A COST COMPARISON:
PENSION OBLIGATION BONDS vs. ECONOMIC RECOVERY BONDS**

(In Millions of Dollars)

	Pension Obligation Bonds	Economic Recovery Bonds	Additional Cost of Pension Obligation Bonds
Par amount	\$935	\$930	\$5
Total debt service	\$1,617	\$1,251	\$366
Final maturity	2025	2021	4 years